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SUBJECT: SURVEY: IMPACT OF RISING FOOD/AGRICULTURAL COMMODITY PRICES -- UNITED KINGDOM

REF: STATE 00039410

1.(SBU) Summary: Rising food prices have pushed the UK's consumer price index to three per cent; one per cent higher than the government's target of two per cent. Consumers' food bills are increasing, and food imports to the UK have not grown. UK farmers have increased grain production, but are not profiting from increased prices. Higher inflation is not undermining the government, but contributes to the growing loss of public confidence on PM Brown's ability to manage the economy. The British public is not highly supportive of biofuels. The Prime Minister hosted a "food summit" and HMG is offering an aid package for countries experiencing food shortages. This cable follows the outline of questions contained in ref a. End Summary.

Demand

¶2. (U) Rising UK food prices are expected to add approximately GBP 572 (\$1,144) to a family's annual grocery bill according to the price comparison website mysupermarket.co.uk. Figures released by the Office for National Statistics (April 14) showed wholesale food prices rising by 8.5 per cent over the last year. According to MySupermarket.co.uk, a basket of 24 staple foods has risen by an average of 11 per cent in the past 12 months. To an average family of four with a weekly grocery bill of GBP 100 (\$200), this increase represents an increase of GBP 572 per year. According to the Index of Producer Prices of Agricultural Products (2000=100), the price of cereals increased from 135.5 to 236.4 between February 2007 and February 2008. Over the same timeframe, fruit increased from 135.4 to 153.9, vegetables increased from 138.8 to 152.5, and industrial crops (potatoes, sugar beet, oilseed rape) increased from 115.8 to 260.8. The Index of Purchase Prices of the Means of Agricultural Production (2000=100) shows that animal feedingstuffs have increased from 118.3 in February 2007 to 163.5 in February 2008. Statistics have not yet been published as to how these price increases will change consumption patterns.

¶3. (U) The most recent balance of trade statistics (February 2008) show imports of food and drink falling, having increased throughout 2007. However, since 1995 the UK's trade gap in food, feed and drink has widened by 66.6 per cent. The value of imports in 2005 was GBP 23.4 billion (\$46.8bn) compared to GBP 9.9 billion (\$19.8bn) for exports. The UK is currently 58.1 per cent self sufficient. Since 1995 self sufficiency in all food has decreased by 21.2 per cent (Source: The Department for Environment, Food and Rural Affairs). The group for which the UK has the largest trade deficit is fruit and

vegetables while the smallest trade deficit is with drinks. Non-indigenous type commodities accounted for 39 per cent of total food, feed and drink imported to the UK in 2005.

Supply

¶4. (SBU) Real returns to UK farmers are not growing at the same rate as wholesale retail food inflation, limiting their reaction to rising prices. However, UK grain farmers have increased the area planted to arable crops, the increased prices available being one of a number of drivers. In the case of wheat, anecdotal evidence also indicates an increase in the proportion of high-yielding (but lower quality) variants planted. UK livestock producers are becoming increasingly vocal about the increased feed costs with the hog sector going so far as to suggest that mainstream production might cease in the UK. Higher input costs have generally reduced producer margins as retailers are hesitant to increase prices. In the arable sector there is an increased willingness to spend capital on more expensive inputs. However, UK farming in general is coming out of a period of very low to negative returns. Therefore, debt management is superseding new investment.

5.(U) The EU's compulsory set-aside requirement has been reduced to 0 per cent. (Note: Previously, farmers in the EU needed to leave ten per cent of land fallow so that it recovers between crops. End note.) Recent government figures suggest that around half of the UK land that was

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in set-aside has been taken back into food production - about half a million acres. Additionally, while prices of commercial and residential properties are falling in the UK, the price of agricultural land is soaring. Good quality arable land that was fetching GBP 3,000-\$3,500 (\$6,000-\$7,000) per acre 18 months ago is now getting twice that. The National Farmers' Union directly attributes the price increases to global food shortages and therefore the real value of food production.

Domestic Politics

¶6. (SBU) The Labour government's stability is not undermined by food price inflation. However, Prime Minister Brown's economic reputation, which has recently come under close scrutiny due to factors such as its response to the crisis at mortgage lender Northern Rock and its unpopular tax reforms, could be the subject of further criticism if inflation remains above the UK's target of 2 per cent for a sustained period.

¶7. (SBU) Public attitudes toward biofuels are changing as organizations such as Oxfam, Greenpeace and Friends of the Earth question not only their environmental impact but also their impact on global food prices. In a recent YouGov poll, commissioned by Friends of the Earth, among the 55 percent of people questioned who knew what biofuels were, fewer than one in seven thought they are the best way to reduce emissions from road transport. At an macroeconomic briefing by Oxford Economics (April 30), a consultancy firm, analysts said they expect HMG to not only review, but to change, its biofuel policy over the duration of 2008 as people begin to realize biofuels "are a stupid idea".

Economy

¶8. (SBU) The most notable impact of rising food and agricultural commodity prices has been on inflation. In April 2008, inflation was 3 per cent, one percentage

point above HMG's target inflation rate. Oxford Economics analysts expect inflation to reach 3 per cent in 2009. Core inflation has actually been falling and wage inflation has remained subdued, therefore increases in CPI can be largely attributed to food and energy prices. The Bank of England expects the impact of rising food prices to feed through into higher inflation in the short term but expects inflation to return to 2 per cent in the medium to long term, according to its February Inflation Report. According to the World Bank, the UK will be a moderate loser in terms of the impact of projected food price increases on trade balances in 2008. Its trade balance is expected to worsen by less than 1 per cent of 2005 GDP.

Environment

¶9. (SBU) Rising food prices per se have not had an appreciable impact on the environment and ecosystems of the UK, including land use patterns, water use, soil quality, and deforestation. Rising demand for organic or sustainably raised vegetables, poultry, meat and dairy products is driving interest in lower use of pesticides and fertilizers, which would contribute to better water and soil quality.

Host Government Policies

¶10. (SBU) An April 22 summit hosted by PM Brown addressed increases in food prices. Participants agreed that action needed to be taken both for immediate social protection and longer-term agricultural investment and that care should be taken not to talk up a "crisis." The UK press release following the meeting included a broad range of proposed actions that the UK plans to pursue both domestically and internationally. HMG will increase support to the poorest. In addition to the GBP 50 million (\$100m) per year it spends on social protection and safety net programs in Africa, HMG pledged an extra GBP 30 million (\$60m) to support the World Food Program, and an extra GBP 25 million (\$50m) to Ethiopia for their national safety net program. HMG also said it would work in the G-8 for an international strategy and will work to

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achieve a successful WTO deal, including a substantial 'aid for trade' package to help build the trading capacity of the poorest countries. Additionally, the UK will work within the EU to further reform the EU's Common Agricultural Policy (CAP). HMG estimates that the CAP cost UK consumers GBP 3.5 billion (47b) in 2005 through higher prices. Reductions in tariffs and CAP reform would reduce the cost of food to EU consumers and increase the capacity of developing countries to produce and export agricultural commodities.

¶11. (SBU) Domestically, HMG said it will work with consumer groups, food producers, manufacturers and retailers to address domestic price rises. It will also increase research into improving yields. It announced new funds for agricultural research over the next five years. HMG also committed to reviewing its approach to biofuels. It will review its impact on food prices and the environment. If the review concludes that a different approach needs to be taken, HMG will push for a change in EU biofuels targets.

¶12. (U) Also on April 22, the Department for International Development (DFID) announced a GBP 455 million (\$910m) five-year aid package to address rising global food prices. The package is designed to address both short term needs and long term solutions. The UK aid package includes: \$60 million in support of recent appeals by the World Food Programme for countries most at

risk; \$800 million (GBP 400 million) over five years devoted to agricultural research, that will double DFID's current spend and help poor countries grow more food for themselves; and \$50 million (GBP 25 million) this year to boost the incomes of the poorest people in Ethiopia.

Post Programs

¶13. (U) Rising food and agricultural commodity prices have not affected post programs.

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